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C O N F I D E N T I A L SECTION 01 OF 02 SANTO DOMINGO 004196

SIPDIS

SENSITIVE

STATE FOR WHA, WHA/CAR, WHA/PPC, WHA/EPSC. EB/OMA;  
NSC FOR SHANNON AND MADISON; LABOR FOR ILAB;  
USCINCSO ALSO FOR POLAD; TREASURY FOR OASIA-MWAFFER

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TAGS: [PGOV](#) [EFIN](#) [DR](#)

SUBJECT: DOMINICAN PROGRESS ON IMF STAND-BY

Classified By: EcoPol Counselor Michael Meigs. Reason: 1.4 (b) and (d)

11. (SBU) Summary: IMF Regional Director Guy Meredith and Resrep Ousmene Mandeng told DCM and staff on August 24 that things are going generally well for the Dominicans on the macroeconomic side and they foresee no obstacles to completing the combined first and second reviews of the standby. This will lead to the next distribution of funds, which the Dominicans do not need at this point. IMF reps mentioned two areas where targets are not being met: energy sector reform and structural reform. IMF expects the continuing high world market petroleum prices to worsen the outlook for the country's energy sector, which remains in crisis. He said that the outlook for 2006 was problematic, citing revenue shortfalls, especially in the energy sector. End summary

12. (SBU) On August 24 IMF Regional Director Guy Meredith and Resrep Ousmene Mandeng provided to DCM and Embassy Staff a status report on the IMF review of this year's standby arrangement. Delays in Dominican structural reforms and other measures had pushed back completion of the first review, originally due in June, so they will prepare a single report to submit to the Board in early October.

13. (SBU) Meredith said that things are going well in several areas, calling macroeconomic performance "not bad," financial markets and debt restructuring favorable, and growth at an estimated 5.8 percent--statistically at least--good. The DCM asked whether the Central Bank figures on inflation and growth could be believed; Meredith said that another IMF team had looked at the numbers in early August and found no evidence that they were intentionally enhanced or misleading, only that the Central Bank was using old methodology. For instance, the Central Bank has been using for calculations a 1971 model, which does not correspond to current economic structures. The Central Bank plans to put a newer, 1993based model into service in early 2006.

14. (SBU) Growth has been concentrated in telecoms and consumption, much of the latter based on growth in imports, rather than creation of new jobs. Meredith said that the low inflation figures are credible, referring to press reports indicating that many items have fallen in price. The Central Bank is expecting inflation to pick up in the second half of year, owing to the increase in petroleum prices. On exchange rates, Meredith said that there has been some intervention in the exchange market, particularly early in the year to prevent a rise in peso value but he did not see a problem of government manipulation. Net Reserves are now USD 650 million, but the pace of growth in Central Bank accounts has dropped due to a decrease in interest rates.

15. (SBU) IMF noted that even the Central Bank is expecting depreciation of the peso at some point, perhaps later in 2005. The rapid growth in imports suggests that the current account, now in surplus, may turn negative next year.

Troubles on the Horizon for 2006

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16. (C) Meredith said that all major elements of debt restructuring are in &pretty good shape.8 Commercial bank debt is not a problem. However, macro/fiscal prospects for 2006 do not look reassuring due to ongoing electricity subsidies and the decision to maintain a costly cooking gas subsidy. There are provisions required in the 2006 budget that will be problematic if there are no offsets. In addition, the Dominican Government plans to implement for the first time ever, a 2003 law that transfers 0.5 percent of GDP (10 percent of the budget) to municipalities and other groups such as the judiciary. This had been suspended in earlier years. Meredith expressed concern that the Dominicans have yet to find an offset.

Energy -- Still Problematic

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17. (C) Elaborating on the electricity problem, Meredith said

that the Dominicans did not achieve the revenue results targeted in the first half of the year. The Cost Recovery Index (CRI) stalled this past spring when distribution companies failed to reduce the theft of electricity. What was to have been a USD 350 million government subsidy will end up being USD 500 million by year end. The government is in the process of putting private management in place at distribution companies EdeSur and Ede Norte, but has been slow to finalize the contracting and key positions remain unfilled. The visiting Fund team is perplexed by the problem and the government's inability or unwillingness to address it. People are stealing power, the government knows and denounces the theft, but people go on stealing unpunished. The IMF is not sure that private management will fix the problem, since it is not clear that the government will allow the managers to implement the necessary actions. The management replacement plan has been around since January yet there has been no movement, perhaps because the government is not willing to take the hard decisions until after 2006 congressional elections.

#### Banking -- Mixed Results

18. (C) On banking reform, Meredith said that progress has been mixed. The Dominicans still need to establish formal legal independence of the Central Bank and the Superintendent of Banks. The banking sector as a whole is not strong because of its lopsided loan portfolio, which is too concentrated in the top 100 borrowers. But it is not taking unreasonable risks. Most banks are making profits, though not large ones.

19. (C) The strongest trait of Central Bank Governor Valdez Albizu is his independence. He is prudent and wants to retain an important role for himself. Director General for Internal Revenue Juan Hernandez was put in charge of tax reform. Despite resistance from private banks, Superintendent of Banks Rafael Camillo has done well and banks are coming into line.

With High Reserves, Next IMF Disbursement Not Needed.

10. (SBU) The Fund's staff expect that the Board will approve the next disbursement in October, based on good performance. The Dominicans may choose not to draw on the next disbursement, because reserves are high and the funds cannot be used to pay down the quasi-fiscal deficit. Still completion of the review now will be helpful for the Dominican Republic's global image.

KUBISKE